INVESTMENT CHALLENGES FOR OLDER AMERICANS: THE RISKS IN INVESTING IN VIATICAL CONTRACTS AND VARIABLE ANNUITIES

For older Americans investing presents special challenges. There is always some element of uncertainty in investing, but when the money at stake represents a lifetime of savings or a lump sum pension payment-money that is crucial for retirement and cannot be recaptured-taking undue risk may spell disaster. All investors, but especially older investors, should take time to understand the various investment products they may be considering. Upon receiving a lump sum pension payment or an early retirement distribution, a person may feel pressure to invest it quickly in order to avoid adverse tax consequences. Sound investing requires careful consideration.

It can sometimes be difficult for older investors to know when the risk is too great, or if they are being misled into investing in a product that is unsuitable to their needs. Recently, securities salespersons and insurance agents have been hyping investments that can be unsuitable for older investors, including viatical contracts and variable annuities, or fraudulent in the case of many promissory note investments.

Insurance agents and others have hyped viatical contracts as a lucrative and safe investment. In fact, these investment products are exceptionally risky. Viatical contracts are interests in the death benefits of terminally ill patients such as AIDS and cancer victims. The insured gets a percentage of the death benefit in cash, supposedly to improve the quality of their lives in the last days. Investors get a share of the death benefit when the insured later dies, after commissions are paid to the viatical investment broker.

Simply because an insurance company may have issued the underlying policies does not mean that the investment is risk-free or secure. Because of uncertainties in predicting when a terminally ill person is going to die, these investments must be considered extremely speculative. Investors often receive only fractional interest in an insurance policy and must depend on the promoter or others to pay the premiums and keep track of the policyholders. If the premiums are not paid or the policyholders disappear, the viatical interest could be become worthless. There have been instances where the policyholder misrepresents his or her physical condition to the insurance company. Under those circumstances the insurance company could void the policy leaving investors with a worthless piece of paper.

Variable annuities also can be an unsuitable investment for older persons, as well as for other investors. Variable annuities have become popular investment products among insurance agents and other salespersons who earn hefty commissions in selling such products. Variable annuities generally include investments in stocks and bonds, whose values rise or fall with market conditions, and whose investment earnings are tax-deferred.

One financial publication estimated that half the variable annuities are sold to persons over 60. For older persons, variable annuities can be unsuitable investments, especially if the investors are already invested in stocks. Although the tax deferral feature of variable annuities may has its advantages; it may take a long time for the benefits of tax-deferred compounding to overcome the expenses related to a variable annuity contract. One financial publication, *SmartMoney*, estimated that a typical bond fund in an annuity (earning 6.5 percent a year) took between nine and fourteen years to equal the return on a regular taxable bond mutual fund, depending on the investor's tax bracket. For a stock fund (with an assumed annual rate of return of 10 percent), *SmartMoney* estimated that it would take the variable annuity between 21 to 40 years to catch up, depending on the tax bracket and fund dividend.

Beware of self-proclaimed financial advisers. Just because a broker or insurance agent calls himself a "financial analyst" or "investment consultant" does *not* mean that he or she provides objective financial advice particularly where he is selling high commissioned products such as variable annuities or viatical contracts. Do not confuse a sales pitch with impartial advice that is suited to your particular goals, risk tolerance, and current assets. Be wary of brokers or insurance agents who seem overly eager to put you into exotic investments you have never heard of before. Ask the broker or insurance agent if he or she will receive any extra commission or other incentives (such as a prize or a trip) for selling you a certain product. Investors are entitled to know how much of their investment is going toward commissions and other expenses. Every dollar that goes into such expenses is one less dollar available for an investor's earnings.

To avoid bad investments, an investor should focus on the whole range of the investment's characteristics, not simply on promises of a high return. Before investing, an investor should understand the cost, degree and nature of the risks, investment goals (e.g., income with a high degree of safely), performance history, and any special fees associated with the investment. Never assume that the investment is federally insured, low risk, guaranteed by an insurance company or state insurance guaranty association, or guaranteed to deliver a certain return. An investor should never rely on oral statements for assurance--get every promise in writing, and make sure the information is understandable. Once obtaining that information, check it against investment goals and risk tolerance to see if the recommended type of investment is a good fit. Investors may investigate the product with the assistance of a trusted and independent financial adviser.

Never be afraid to ask questions at any stage of the investment process. Investors are in control of their money, even if they hire an expert to help them manage it. Investors have every right to ask a financial professional why he or she is making a certain recommendation, what the alternatives are, what the risks are, and how much he or she will be paid for the transaction. If there is uncertainty about a product, or what is being represented, investors should ask questions until they understand. If someone states that the uninsured investment is as safe as "the money in your pocket," it is time to walk out the door... while your money still is in your pocket!

The Securities Division of the Arizona Corporation Commission can provide information about the registration of investments, brokers and investment advisers. The Division can also provide other public information relating to the securities industry. Our telephone number is **602-542-4242** or toll free, **1-866-VERIFY-9** (outside metro Phoenix and Arizona). You can also send us an email at **info@azinvestor.gov.**

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